



Client Gathering: December 2, 2009

Q&A – Research Team

Q1: I have a three-part question about General Electric:

- 1. What's your outlook for GE?**
- 2. Is GE a value stock?**
- 3. Are there better Fenimore investment ideas than GE?**

A: John —

- The outlook is that next year will be a tough one for GE for three reasons which are public knowledge:
 - The orders for new equipment worldwide will be down 10 to 15 percent due to the economic decline.
 - Like many large public and private organizations, their pension expense will increase (about \$1 billion) which is a significant drag.
 - They are going to continue to have losses in their finance company.Earnings will probably be down, but that doesn't mean the stock won't increase.
- It's definitely a value stock — it's out of favor. The main issue is credit losses. When people are comfortable with what the credit losses are going to be in the finance company, the stock should go up.
- Fenimore may sell GE, but that doesn't mean that if you own the stock separately you should sell it. We have small- and mid-cap names that meet our criteria that we'll probably switch it into.

Q2: We as clients have some good investment ideas based on businesses we know intimately that your Research Team may not know. Why don't you ask each client to suggest one research idea?

A: Tom — We do get ideas from our investors although it is not a formal process. In fact, we just looked at a business a client recommended. I'll ask our Private Client Services Team to look at ways to receive your ideas. Thank you for that suggestion.

Q3: What do you recommend in the fixed income area?

A: Andrew — People's risk tolerance has changed and, based on their age, some clients have more of a demand for fixed income. We've always invested in some fixed income and even before things got rough, we were discussing ways to offer fixed income to our clients. So for the past year we've been doing that. We've also spoken with some of you as it made sense. We will certainly continue this process because we feel it is important to handle this individually. We have no miracle cure for the low yields. Our approach to fixed income is very conservative since we know this is not where you want to take a lot of risk. We're buying AA and AAA bonds with

very low yields — what the market is bearing in the short-term. Also, we're not buying long bonds because if interest rates go up, owning a 30-year bond at four percent would probably be a terrible mistake. We do have a fixed income strategy, so if you're interested, please speak with your portfolio manager.

Q4: *What does the future look like for our children and grandchildren?*

A: Tom — If you reflect on different periods in the history of our nation including the Depression, there would have been times when people said that their grandchildren had no future at all. Today, if you look around the country and see all the small businesses that are starting, and that's what our economy was built on, there's a lot of opportunity for those who want to work and get ahead. So I think if people are industrious, they can do very well.

A: John — Unemployment is the hottest topic. As a percentage of jobs lost in a down cycle, this is the worst since 1969. We've lost seven million jobs and may not get as many back. If you look at the last two recessions, it takes, on average, three years for the employment rate to rebound to its previous peak so it takes a longtime. Also, all the things that are supposed to occur before jobs return are happening right now: productivity is at an all-time high; overtime hours have increased; the temporary staffing index has been up every week since July which is typical before businesses commit to full-time employees; and job-cut announcements are at their lowest level in two years. So in the next three to six months we should see job growth. Finally, I'm looking at colleges with my son and when you visit campuses, the enthusiasm of students about what they want to do is unbelievable! It excites me about the future just listening to them!

A: Paul — There's a culture of innovation in America. After the Tech Bubble, the companies I talked to said they wanted to hire foreigners and not Americans because of their work ethic. The other thing that happened is that a lot of talented, well-educated people came into our country because they saw it as the land of opportunity. Our capitalistic system really does work and we're in a period right now when despite the distress, the culture continues to grow. The younger generation needs to understand that they must apply themselves and education paves the road to success. We can be the role models to demonstrate that it really does work!

Q5: *I've always seen Fenimore as a small-cap value manager. With GE and Johnson & Johnson in our portfolios are you changing your direction?*

A: Tom — No. I mentioned in my opening remarks that we established the Research Fund this past year. One of the reasons we created it was to invest in small-cap companies; businesses that are anywhere from about \$50 million to \$500 million in market cap.

A: John — To reiterate, the answer is no. We are researching small- and mid-sized companies. The Research Fund, or R&D Fund, is helping with our efforts.

A: Andrew — I also wouldn't be surprised if we unwind the larger names in time.

Q6: *I would like to thank Fenimore for not wavering from its commitment to the community over the past year. I'm hearing that there are some good health care insurance companies to invest in. What are your thoughts?*

A: John — Fenimore invests in about six health care companies. Our strategy on health care is that we know there's going to be change, but we don't know what it's going to be so we wanted to be diversified and own positions in several businesses. For example, if government legislation hurts one company, perhaps another will benefit. We're not looking at health care insurers because they're too difficult to figure out due to pending legislation.

A: Tom — And most of our health care holdings don't have large exposure to the areas the government is considering legislating.

Q7: How are we going to recover our lost jobs when most of our manufacturing is now overseas?

A: John — We hear often that the U.S. doesn't make anything anymore. I don't think that's necessarily true. We don't employ as many people in manufacturing as we used to, but we manufacture a lot and the companies we are invested in are selling products worldwide. In September Marc and I were at Joy Global headquartered in Milwaukee. They make huge, heavy machinery for mining. As we toured the floor we asked them where their orders were coming from and they said Australia, China, Chile, and South Africa. My point is that if you're in the mining business and want the greatest equipment in the world, it's made in Milwaukee. Another holding of ours, Donaldson headquartered in Minneapolis, manufactures the best filters for industrial applications around the globe.

If you think about what we import, in general, they aren't significant value-added products. However, what we export are goods like the best mining equipment in the world, the best spray painting equipment in the world, the best filters, and the best barcode printers. While we may not employ as many people in manufacturing as we used to, we have holdings in a lot of great manufacturing companies. They also open the door for us to benefit from growth in the global markets since they sell their products worldwide.

Q8: How do you feel your portfolios are positioned assuming a no-growth environment?

A: John — We invest in companies that generate a lot of free cash. For example, if one of our holdings generates \$1 billion annually in revenue, it probably produces about \$100 million in free cash a year. That cash can create value. If in five years their sales are flat and the \$100 million in cash flow is the same, the stock can be higher if they bought their shares back, paid their debt down, made an acquisition, or paid a special dividend. The value of the business is its cash profits. So the types of companies we invest in create value with their cash flow. (If you would like more details, we can email you the article from the summer edition of *The Value Investor* newsletter.)

A: Paul — The institutional imperative for any company is to grow. If a company only grows at the same rate as the overall economy, you can't justify bonuses to management. These businesses are not happy just to expand one to two percent. They generate cash and I think they are going to make acquisitions in order to grow, especially in a slow economy. My favorite phrase is that 'They'll make their own luck!' They can take their acquisitions and consolidate them making them more efficient; maybe there's a new technology or they can vertically integrate their production process as well. So there's a lot these businesses can do and no one is standing still. Their stocks can do okay in a no-growth environment because the marketplace recognizes that they're on the offense.

A: John — On the flipside, our small- to mid-sized quality companies, with little if any debt, can also get acquired at a nice premium which will generate a return on investment.

Q9: Are you reading anything into Warren Buffett's recent purchase of a railroad?

A: Tom — Yes, I am. But you have to think very long term. His bet on the railroad is that it transports goods and services and there will be more and more in the future that need to be transported via a low-cost method. I think it bodes well for our economy.

Q10: In the media you hear often about the "Double-Dip." Are we prepared for this or is it a scare tactic?

A: John — The "Double-Dip" refers to the 1980s when there was a fairly long recession from '80 to '82 and there was declining GDP — and then it went up and then down again. What

happened is that the Fed started to raise interest rates pretty early in the cycle and caused the second dip. We're certainly not in that position today although there's always the possibility that the economic improvements we're seeing may stall due to government pullback. If that occurs, our companies should react similarly to last year and do better than most because they are high quality companies with little or no debt, generate plenty of cash flow, and have strong management teams.

Q11: *It seems that value investing has now become so popular among investment pros. Will that make it difficult to find under-priced stocks for our portfolios going forward?*

A: John — Intuitively, one may believe that. Value investing had its official birth in 1934 when Benjamin Graham wrote his book *Securities Analysis*. So it has been around for 75 years and there are actually a small number of investment managers that employ a strict value approach. It is actually a very unpopular approach to investing because it is difficult psychologically to buy stocks when they are out of favor or when the markets are declining. Lastly, there are nearly 10,000 publicly traded companies and we only need 50 holdings! So opportunities are abundant.