



# FAM Funds

MANAGED BY FENIMORE ASSET MANAGEMENT, INC.

## FAM EQUITY-INCOME FUND LETTER TO SHAREHOLDERS – ANNUAL REPORT 2009

December 31, 2009

### Dear Fellow Equity-Income Fund Shareholder:

In 1980 the U.S. Olympic Hockey Team accomplished the impossible at Lake Placid, New York — they beat the Soviet Union! The Soviet Team was considered to be unstoppable. They were among the best players in the world and dominated the sport taking home the gold medal in the previous six Winter Olympic Games.

At the start of the 1980 Games there was little expectation that the U.S. team could even qualify for a medal, much less win the gold. Even as the team advanced nobody believed that they could pull off a victory over the Soviets. This match-up came at the height of the Cold War and despite the impossible odds going into the game, the sense of hope was clear and American flags were everywhere. In one of the greatest upsets in sports history, the American team defeated the Soviets four goals to three.

Many people believe the reason this particular game is so memorable and invokes so much emotion is because of our country's status in those days. We had just exited the '70s where we withdrew from the unpopular Vietnam War, inflation was soaring, interest rates were in the mid-teens, and the economy was again entering a recession with unemployment marching toward 10%. Gasoline prices skyrocketed and consumers had to wait in long lines to refill their tanks. Worst of all, Iran was holding American hostages and a rescue attempt turned out to be a disastrous failure. Our nation's confidence was near an all-time low.

Looking back, the casual observer would likely conclude that putting money into the stock market in 1980 was a terrible investment. There were certainly many more negatives than positives. Even with this scenario, the 1980s AND 1990s proved to be terrific decades for equity investors. The S&P 500 Index annualized returns for the '80s were +17.5% and +18.2% during the '90s. These returns are well ahead of the long-term average returns for stocks. The simple reason for this is that stocks were priced as though things would never get better. It turned out that stocks were cheap because the environment *did* improve.

As we enter 2010, the environment is quite similar to 1980. The United States is emerging from a deep, two-year recession where we saw massive layoffs and unemployment above 10%. Our financial system was on the brink of collapse and required the Federal Government to step in to avert disaster. As a result, the national debt has risen to a troubling level and there is no sign that government spending will abate. Iran is continuing to cause problems on the world stage and we are fighting a war in Afghanistan. It's clear from recent opinion polls that America is suffering from a decline in optimism.

Looking forward, we believe the next decade may be rewarding for equity investors for a number of reasons. First, we are starting from a similar position to 1980; consumer confidence is low and there are significant economic hurdles to overcome. However, we believe the economy has stabilized and we are seeing clear, tangible improvement in economic data. Additionally, stock returns were negative from 2000 to 2009 with the S&P 500 Index losing -0.95% (Note: the FAM Equity-Income Fund returned +5.91% over the same period). This S&P return is well below the long-term average for stock returns of +10% to +12% which signals that stocks may begin performing better and stock returns may go back to their historical, long-term average. A year-end article in the *Wall Street Journal* titled, "The Worst Decade," highlighted that stock returns over the last 10 years were worse than the decade of the 1930s — the Great Depression era — when stocks declined by -0.22%. The data in the article also showed that over the last 18 decades, 10-year stock returns have only been negative twice. The odds are in favor of positive stock returns going forward.

While we don't know if there will be a pivotal moment like the 1980 U.S. Olympic Hockey Team win, we are bullish on stocks and have positioned the portfolio to benefit from an improving economy over the long term. We are not trying to imply that stocks will have a blockbuster 2010 or 2011; we are merely making the case

for improved equity returns over the next decade versus the last.

## 2009 in Review

2009 was a year that defied expectations. Few people expected the market to collapse by an additional -25% in the first quarter after the severe decline in 2008. Even fewer people expected that the market could climb more than +64% from its lows to end the year up +26.46%. "Turbulence" understates what occurred in the 2009 market.

If we just look at the starting and ending points for the year, it was a very good year. The FAM Equity-Income Fund gained +21.43% for the year ended December 31, 2009. This compares to the Russell 2000 Index which gained +27.17% and the S&P 500 Index which grew +26.46% for the period. Any time the Fund and market rise more than +20%, it's a good year in our book.

During the first half of the year we were large stock buyers. We started the year with cash representing 22% of assets and took advantage of our reserve buying shares of multiple companies at low prices. We added new holdings and increased existing positions when the share prices declined to levels too low to pass up. It proved to be a very good time to buy stocks. We also sold the remaining shares in a company that we believe was permanently impaired from the financial crisis. Later in the year we took profits by trimming some stocks that were selling near their 52-week high prices and had grown to outsized positions. We used the proceeds from these sales to add another new company and increase positions that were well below our estimate of their intrinsic value.

## Best and Worst Performing Companies

The best performing company in the portfolio for the year was Meredith Corporation. The stock rose +85.5% and added \$2.136 million to the value of the portfolio. Much of the stock appreciation was a rebound from its irrationally low price at the end of 2008 when it was one of the worst performing stocks in the Fund. Another reason for the recovery is that Meredith's magazine titles are performing well versus the competition. They are gaining market share as measured by advertising dollars. We see signs of the advertising market rebounding and anticipate a more favorable environment in 2010.

The next best performing company was Franklin Resources which gained +66.5% adding \$1.512 million to the portfolio. This is an investment company offering both equity and bond mutual funds. The company benefited from increased assets under management as the stock market bounced back. Their funds have performed well over the period and have attracted new assets as well.

The worst performing company was Brown & Brown, which lost -12.6% and subtracted \$0.560 million from the value of the Fund. This company is an insurance broker which takes no insurance risk on their balance sheet. They simply sell insurance and earn a commission. Weak insurance rates and the contraction in the economy have impacted results. Brown & Brown is well managed and has a history of producing terrific results. We expect the environment will improve and results will follow suit.

The second worst performing company was Courier Corporation. The stock declined -15.7% for the year which negatively impacted the portfolio by \$0.436 million. Earnings were hurt by excess book printing capacity as well as higher losses at one of their publishing companies that sells do-it-yourself books to Lowes stores. Management completed major restructuring at the publishing unit which should lead to improved results in the current year. Despite the depressed results, Courier is one of the most undervalued stocks in the portfolio and has a dividend yield of +5.8%. Potential returns from these levels are attractive. For example, if the stock price appreciates +10% over the next 12 months, then the total return will be +15.8% (10% + 5.8% in dividends). This would be a very satisfactory return.

## Dividends

Every company in the Fund pays a dividend. We look for companies that pay a meaningful dividend and can grow over the long term. As a company's cash flow increases, the amount of the dividend paid to



FAM Funds are distributed by Fenimore Securities, Inc. Member FINRA/SIPC

shareholders may also expand. Over several years this can be a very substantial number.

Another benefit of dividends is that they are relatively steady compared to capital gains. At any point in time the future appreciation or depreciation of a stock is generally unpredictable. If the price-to-earnings ratio of the stock contracts, the price will come down. If earnings grow, the price should go up. On the other hand, dividends are much more predictable since they are paid out of cash flow which generally fluctuates less than stock prices. What this means to the investor is that they can count on dividends more than they can count on stock price appreciation.

A further benefit of dividends is that once the cash is paid to shareholders, it can't be taken back. This is important because oftentimes when cash accrues on a company's balance sheet, management has the uncontrollable urge to spend it — sometimes wisely, sometimes not. One of the popular competing alternatives for cash use is buying back stock. This benefits shareholders over time only if the stock price goes up. If the stock price goes down, the shareholder hasn't received any benefit. I think the saying goes "a dividend in the hand is worth two in the bush."

There were four companies in the Fund that lowered their dividends during the financial crisis to conserve cash and strengthen their balance sheets. Given those unprecedented circumstances, we were in favor of these actions. We have kept a close eye on these businesses and are confident that their cash flows support the current dividend. On the other side of the coin, we saw a number of companies in the Fund increase dividends this year which we believe is a good sign for the future.

### Final Thoughts

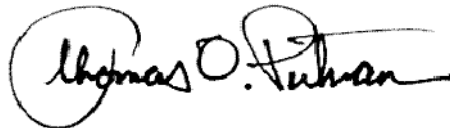
The crowd counted down the final ten seconds of that historic hockey game. When America won the crowd erupted chanting U-S-A! U-S-A! U-S-A! Like those spectators, we are also bullish on the U.S.A. We are also bullish on stocks, particularly our holdings. We know the companies well through our long-term ownership and relationships and are confident in their future prospects. While 2009 was tough, it gave us the opportunity to position the Fund to take advantage of an improving economy.

We appreciate your continued support and are working diligently on your behalf.

Sincerely,



Paul C. Hogan, CFA  
Co-Manager



Thomas O. Putnam  
Co-Manager

**For the FAM Equity-Income Fund's Top Ten Holdings, Performance History and Disclosure, please see the next page.**



**FAM Funds**  
MANAGED BY FENIMORE ASSET MANAGEMENT, INC.

FAM Funds are distributed by Fenimore Securities, Inc. Member FINRA/SIPC

**FAM EQUITY-INCOME FUND TOP TEN HOLDINGS**

<b>Name</b>	<b>% of Total Inv.</b>
John Wiley & Sons	6.0%
Stryker Corporation	5.8%
Johnson & Johnson	5.2%
McGrath RentCorp	5.2%
Meredith Corporation	5.0%
Donaldson Company	4.9%
IDEX Corporation	4.6%
Courier Corporation	4.5%
Ross Stores	4.5%
Brown & Brown	4.4%
<b>TOTAL INVESTMENTS</b>	<b>\$77,564,501</b>

*The portfolios are actively managed and current holdings may be different.*

**AVERAGE ANNUAL TOTAL RETURNS AS OF DECEMBER 31, 2009**

*The performance data quoted represents past performance.*

<b>FAM EQUITY-INCOME FUND</b>	<b>SINCE INCEPTION</b>	<b>10 YEAR</b>	<b>5 YEAR</b>	<b>1 YEAR</b>	<b>TOTAL ANNUAL FUND OPERATING EXPENSES*</b>
Investor Shares	6.75% (4/1/96)	5.91%	-1.32%	21.43%	1.72*

**\*Disclosure:** The actual total annual FAM Equity-Income Fund operating expense is 1.40%, after reimbursements, as reported in the Fund's 12/31/08 audited financial statement. The "Total Annual Fund Operating Expenses" includes Acquired Fund Fees and Expenses which are those expenses incurred indirectly by the Funds as a result of investments in shares of one or more investment companies or pooled investment vehicles (referred to as "Acquired Funds"). The costs associated with investments in the acquired funds are not direct costs paid by Fund shareholders.

*Past performance is not indicative of future results, current performance may be lower or higher than the performance date quoted. Investment returns may fluctuate; the value of your investment upon redemption may be more or less than the initial amount invested. Please consider a fund's investment objectives, risks, charges and expenses carefully before investing. The FAM Funds prospectus contains this and other important information about the FAM Value Fund and FAM Equity-Income Fund and should be read carefully before you invest or send money. The principal risks of investing in the Funds are: stock market risk (stocks fluctuate in response to the activities of individual companies and to general stock market and economic conditions), stock selection risk (Fenimore utilizes a value approach to stock selection and there is risk that the stocks selected may not realize their intrinsic value, or their price may go down over time), and small-cap risk (prices of small-cap companies can fluctuate more than the stocks of larger companies and may not correspond to changes in the stock market in general). For performance data that is current to the most recent month-end for each fund as well as other information on the FAM Value Fund and FAM Equity-Income Fund, please go to [www.famfunds.com](http://www.famfunds.com) or call (800) 932-3271.*

*The recent growth rate in the stock market has helped to produce short-term returns for some asset classes that are not typical and may not continue in the future. Because of ongoing market volatility, fund performance may be subject to substantial short-term changes.*