



July 2010

Dear Fellow Shareholder:

Pessimism reclaimed the spotlight during the middle of the second quarter. Just when many felt that the economy and stock market were gaining momentum and turning the corner, the proverbial apple cart was upset. In May, fears generated from sovereign debt crises in Europe and the related impact on global economic growth caused feelings of anxiety and scared many investors out of the stock market. As a result, the S&P 500 Index declined -11.4% in the second quarter and was down -6.7% year-to-date.

Many are extending this negative worldview to their investment outlook. We understand that it is difficult to escape the immense negativity felt from slow growth in most global economies, the chance of a double-dip U.S. recession, federal and state budget deficit spending, and the BP oil spill. Many people tend to focus on the negatives and are often led astray from the positive developments until they are literally right in front of their faces as news headlines.

Ultimately, it is the profitability of businesses that drives the stock market higher. What may come as a surprise then, despite the litany of gloom and doom, is that corporate America is strong and continues to gain strength as evidenced by earnings growth. At the time of this writing, second quarter corporate earnings have not been released, but we observed good results for those off-calendar quarter companies that did report.

In their most recent quarterly releases Federal Express and 3M – which are not owned in the Funds but are global bellwether companies – projected strong results for the near future. Federal Express reported a solid quarter and is projecting in excess of 20% earnings growth for their fiscal year ending May 2011. 3M told investors that their revenue for the second quarter will exceed expectations. FAM Funds' holdings Bed Bath & Beyond, CarMax, and Donaldson, among others, each reported strong results with growing sales, cash flows, and improving balance sheets.

While some feel the stock market may never rise, interestingly, today's valuations are at levels that could yield reasonable future returns (currently the S&P 500 Index P/E ratio is 15 times). Still, some investors ignore valuation levels and want nothing to do with equities because they are paralyzed by fear and focused on variables they cannot control – the unknown outcomes of world issues. We are concentrating on the variables we *can* control – outstanding businesses



and the appropriate valuation levels to invest in stocks for future growth. We continue to do this despite these short-term occurrences because they will likely have very little influence on the long-term viability of the underlying businesses.

Again, we call your attention to the financial staying power of the companies we invest in on your behalf. Should the economy relapse into a state of malaise, their financial strength will help them endure as we observed in the 2008-2009 decline. We are looking deeper than short-term stock prices. We are examining the fundamentals of the business - its competitive advantages, unique product/service offering, cash generation, management's track record, and future growth prospects. We hope this helps quell any anxiety you might have and keep you focused on the reason you invest in the U.S. stock market – long-term growth.

In these challenging times we appreciate your confidence in us more than ever. We always welcome your calls at 800-932-3271.

Sincerely,

Thomas O. Putnam
Chairman
Fenimore Asset Management, Inc.

Research Team

Andrew F. Boord
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Dear Fellow Value Fund Shareholder:

Through June 30, 2010, the net asset value of the Investor Class of the FAM Value Fund was \$39.16. This represents a decrease of -0.4% from the beginning of the year. For comparison, the S&P 500 Index decreased -6.7% and the Russell 2000 Index declined -2.0%.

2010 Review Year-to-Date

The stock market started the year by continuing 2009's strong rally. At the end of April the S&P 500 Index was up more than 6% for the year. Unfortunately, April proved to be the peak of the first six months. Government debt problems in Europe and renewed fears of a global economic slowdown shifted stock prices into reverse. Since the peak in April, stock prices have declined by more than 15% putting them back in Bear Market territory. The main question being asked today is, "Will the U.S. economy experience a double-dip recession?" No one knows the answer to this and it is out of our control; consequently, we focus on investing in financially superior companies that can still make money in the stock market even if the economy is stagnating.

Portfolio Activity

Given the increase in stock prices earlier in the year, we were net sellers of stocks in the first six months of 2010. We sold partial positions in stocks that we viewed as fairly valued. This list includes Berkshire Hathaway, General Electric, M&T Bank and Martin Marietta Materials. We also sold our entire position in Cognex and International Speedway Corporation.

We did purchase two new ideas – Digital River and Bank of the Ozarks. Digital River is a technology company that provides retailers with a way to sell their software over the Internet. We purchased shares of the company at a little more than two times the cash on the balance sheet. The company has more than \$400 million in cash, minimal debt, and is growing its core sales at a double-digit rate.

Our other purchase was Bank of the Ozarks. This Arkansas bank serves a number of fast growing markets in the Southeast. The CEO, George Gleason, has been leading the company for more than 20 years and has an excellent record. The bank has a very strong capital position, above average profitability, and good credit results.



Performance Detail

Despite the fact that most markets are down year-to-date, one half of our stocks appreciated in the first half of the year. In general, our financial companies performed well with two of our property and casualty insurance companies posting gains, four of our five banks showing a positive return year-to-date, and a 30% gain in our life insurance investment.

Best Performers

The Fund's best performer on a dollar-weighted basis was Berkshire Hathaway (+ 21%) with a gain of more than \$6 million. Berkshire is well known as the investment vehicle of world renowned investor Warren Buffett. The company's operations have performed well and at March 31, 2010, the company had an all-time record book value of \$89,000 per share. In addition to good fundamental performance, the stock was added to the S&P 500 Index which created temporary demand for the stock. We took advantage of this demand and the subsequent increase in price to sell a small portion of our shares.

The second best performer in dollar terms was Protective Life (+31%) for a gain of more than \$3.3 million. Protective's leadership has done a terrific job of managing through the financial crisis and improving the company's financial strength. Over the last 18 months, management has increased the company's capital base by \$1 billion putting the company in a strong financial position. The stock entered the year at a significant discount to our estimate of intrinsic value. As its value has begun to be recognized, the stock has performed well.

The third best performer in dollar terms was Ross Stores (+25%) for a gain of \$3 million. Ross has been an amazing story over the last three years despite the recession and financial crisis. Since the summer of 2007, the stock has appreciated more than 70% compared to a 30% decline in the stock market. The Ross Stores retailing formula of designer clothing at a discount price has been a big hit with consumers.

Worst Performers

The Fund's worst performer on a dollar-weighted basis was money management firm Franklin Resources (-18%) generating a loss of \$3 million. Franklin is a global asset management firm and was impacted by the worldwide decline in stocks. The company is very strong with \$4 billion of cash and significant profits. Given the company's exposure to the stock market we would expect this stock to do well in Bull Markets and poorly in Bear Markets. This is exactly what has happened year-to-date.



The second worst performer in dollar terms was Amsurg (-19%) also with a loss of \$3 million. Amsurg owns and operates ambulatory surgery centers (hence the name) which perform specialized surgeries. While earnings are expected to decline a slight -4%, we can see no fundamental reason for a -19% decline in the stock price year-to-date. With the stock trading at less than ten times trailing earnings and solid cash flow generation, we are holding onto the stock.

The third worst performer in dollar terms was Federated Investors (-23%) with a loss of almost \$2.8 million. Federated is an asset management firm with an excellent franchise in money market funds. The current low interest rate environment is temporarily hurting the money fund business and pressuring Federated's earnings. Over time, higher interest rates should improve the attractiveness of money funds and result in higher profitability for Federated.

Our Investment Strategy

The value of any business is determined by the cash that the business generates and what management does with the cash. Since these are the two main sources of value, we focus our research on these areas and look for companies that have the following characteristics:

High profit margins, significant free cash flow, high returns on invested capital, low levels of debt or other types of leverage, and management with a track record of using capital wisely. We like to purchase this type of company at a low price compared to the company's value.

We invest this way because it provides three important advantages:

- 1) **The risk of permanent loss of capital is greatly reduced.** There are two ways to lose all of your money in an investment. The first is to pay too high a price. For example, in the technology bubble of 2000 people were willing to pay any multiple of earnings to be part of the "new economy." One of the favorites of the day was JDS Uniphase with a stock price of more than \$1,000 a share. Today the company is profitable, but the stock trades for \$9 share. This is a loss of 99% and a permanent loss of capital for those investors.

The second way to have a total loss of capital is to invest in a company with too much leverage or poor asset quality. The recent financial crisis provides numerous examples



of this type of business including AIG, Bear Stearns, Lehman Brothers, and Washington Mutual.

Our approach will avoid these two pitfalls as we invest in strong companies and pay attention to the price that we pay.

- 2) **Financially strong companies can do better than average in poor economic periods.** We like companies with low levels of leverage and significant cash generation because they can do well in *any* economic environment. As demonstrated in the recent downturn which was one of the worst economic environments of the last fifty years, this type of company performed relatively well. During calendar year 2009, all the companies that we own positions in today reported positive earnings per share – every business made a profit and some of our holdings did significantly better than just making a profit. We expect this to be the case in 2010 as well.

Here are two examples of companies that were able to take advantage of the economic turmoil to grow their businesses:

- Bed Bath & Beyond used its financial strength to take advantage of the demise of its most aggressive competitor. Bed Bath & Beyond has continued to open new stores and has a record \$1.8 billion in cash on the balance sheet.
- Brookfield Asset Management took advantage of low prices for assets around the world and expanded their holdings in strategically important railroads, ports, and real estate. These assets will add to the long-term intrinsic value of Brookfield's shares.

- 3) **Companies that generate free cash flow can increase shareholder value in slow economic environments.** Due to the effects of the financial crisis and the large amount of world debt, the consensus view is that economic growth will be below average for the foreseeable future. If this is the case, companies that generate cash flow may still be able to create returns for their shareholders through the wise use of that cash. A company can use its cash to expand the business, reduce debt, pay dividends, or repurchase company stock. All of these actions can increase the intrinsic value per share of stock.



For example, consider one of the Fund’s longtime holdings John Wiley & Sons. We first purchased John Wiley in the summer of 2002 at a price of \$24 per share. Wiley is not a fast growing company. Management usually tells investors to expect sales to grow in the mid-single digits per year. However, the company generates large amounts of cash which has been used to make two significant acquisitions, repurchase stock, and increase the dividend annually. As a result of these actions during an eight year period where real GDP grew at 1.7% per year and the S&P 500 Index returned 2.5% per year, we have earned a 7.3% annual return on our original purchase of John Wiley.

Since economic forecasts are often wrong, no one can be sure what the next six months will bring; nor can they accurately predict the next six years which is more our perspective as we look at longer term horizons. That is why we use our own independent, time-tested and reliable research process to find financially strong, quality businesses that can endure economic cycles and potentially thrive over the long term. History shows that stocks purchased at reasonable valuations have performed well over time and can provide a positive return after inflation — so we will stay the course and strive to protect *and* grow your assets despite what may occur in the short term.

Long-Term Returns

	Average Annual Total Returns as of June 30, 2010				Life of Fund (1/2/87)
	1-Year	3-Year	5-Year	10-Year	
FAM Value Fund					
(Investor Shares)	18.20%	-7.11%	-0.58%	6.40%	9.73%
(Advisor Shares)*	17.77%	-8.20%	-1.58%	N/A	*
S&P 500 Index	14.34%	-9.84%	-0.81%	-1.61%	8.81%
Russell 2000 Index	21.48%	-8.60%	0.37%	3.00%	8.26%

**FAM Value Fund Advisor Shares were launched on July 1, 2003. The return since inception is 2.93%*

The performance table does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares. This information represents past performance of the FAM Value Fund and is not indicative of future results.

FAM Value Fund



Thank you for investing with us in the FAM Value Fund.

Sincerely,

A handwritten signature in black ink, appearing to be 'John D. Fox'.

John D. Fox, CFA
Co-Manager

A handwritten signature in black ink, appearing to be 'Thomas O. Putnam'.

Thomas O. Putnam
Co-Manager



Dear Fellow Equity-Income Fund Shareholder:

For the first six months of the year the Investor Class of the Fund lost a fraction of a percent, declining -0.17%. This compares favorably to the Russell 2000 Index which declined -2.0% and the S&P 500 Index which fell -6.7% over the same time period. We attribute our performance to the continuing rebound of our financial companies as well as consumer and technology investments.

The market made a strong comeback from the lows of 2009 and continued that run until April of this year. At that point investors began worrying about European debt and a softening in the U.S. economic recovery. These fears prompted a sell-off in the stock market and a flight to safety. Today there continues to be much talk of the U.S. having a double-dip recession.

From our perspective it is more important to focus on what we know, rather than what we don't know. Yes, we do see a slowing in the economy, but it is uncertain whether this is merely a pause in economic growth or the beginning of the economy rolling over into recession. It's important to understand that everyone has an opinion on the future, *but nobody* knows how the future will unfold – not even the pundits we see on TV day-after-day.

What *we do know* is that investors are better served being optimistic rather than pessimistic, perhaps even opportunistic. The optimistic investor is always looking for opportunities while the pessimistic investor misses out on the up markets as they seek shelter and put cash under the mattress. This recent market correction has provided us with the opportunity to buy some stocks that have attractive dividend yields.

Portfolio Actions

Over the first half of the year we took advantage of a number of opportunities to increase the dividend yield of the Fund. We purchased Arthur J. Gallagher (AJG) which had a dividend yield of 5.3% as of the end of the quarter, and NBT Bancorp (NBTB) which yielded 3.9%. We also added to our holdings in OneBeacon (OB) which has a dividend yield of 5.9%, U.S. Ecology (ECOL) which yields 4.9%, and Xilinx (XLNX) with a 2.5% yield.

At the end of June, the combined dividend yield of the equities in the Fund was significantly higher than both the S&P 500 and the Russell 2000 indices (See table)¹. Additionally, the five-year historical growth in the dividend is much higher for those companies in the Fund compared

FAM Equity-Income Fund



to the indices. In fact, more than 40% of the businesses in the Fund have increased their dividend this year. The new purchases and additions had a large impact on boosting the yield of the Fund and we continue to look for further opportunities to increase the dividend income even more.

	<u>Dividend Yield (as of 6/30/10)</u>	<u>5 Yr. Growth in Dividends</u>
FAM Equity-Income Fund	3.0%	12%
S&P 500 Index	2.1%	1%
Russell 2000 Index	1.2%	4%

1 Source: Baseline

The Dividend Advantage

Dividends are an often overlooked part of investors' total return, yet they have provided a meaningful percentage of that return. To illustrate this point we can look at the return of the S&P 500 Index and the amount of that total return that came from dividends. Since 1926, dividends have contributed approximately one-third of total return of the S&P 500 (known as the S&P Composite Index before 1957), while capital appreciation has contributed two-thirds². This is why the Equity-Income Fund focuses on companies that pay a significant dividend and have a history of increasing their dividends. We believe that dividends give an investor a “head start” on returns.

A more instructive example on the importance of dividends comes from one of the holdings in the Fund, McGrath RentCorp. Ten years ago, if you had invested \$10,000 in McGrath, you would have received \$6,523 in dividends and your shares would have grown to \$26,376 as of June 30, 2010, for an annualized rate of return of 12.6%. Dividends, which grew annually, are 28% of the return. Stock appreciation accounts for 72%. Your annual dividends would currently be more than \$1,000 – up from \$329 in the first year. McGrath's dividend was a significant and tangible part of the total return.

2 Source: S&P Indices Research Insights: S&P 500 Dividend Aristocrats, January 2010

Best & Worst Performing Companies

Ross Stores (ROST), an off-price retail company, was the largest contributor to the performance of the Fund year-to-date on a dollar-weighted basis. The total return on the stock was +25.5% and added +\$0.9 million to the value of the Fund during the period. After posting +53% earn-



ings growth last year, the company continues to generate same-store sales that are above management's initial expectations. This led management to raise earnings guidance for the full year. The company also raised its quarterly dividend 44% in March of 2010.

M&T Bank (MTB) was the second largest contributor to performance of the Fund in dollar terms generating a total return of +30.8% during the period. The investment added +\$0.5 million to the value of the Fund. The stock appreciated because of earnings that were ahead of Wall Street's expectations. We see clear evidence that the situation in the banking sector is improving. Also, there was speculation by others on Wall Street near the end of the second quarter that M&T would make a transformative acquisition. This speculation also played a role in the strong performance of the stock year-to-date.

The worst performing company on a dollar-weighted basis was Federated Investors (FII) which subtracted -\$0.7 million (-22.9%) from the value of the Fund. Earnings at Federated have been negatively impacted by fee waivers in their money funds business as well as asset outflows. On the positive side, management paid a special cash dividend to shareholders of \$1.26 per share in the first quarter in addition to the regular \$0.24 quarterly dividend.

Courier Corporation (CRRC) was the second worst performing company in dollar terms declining by -\$0.5 million (-11.4%) during the period. Courier traded down in the quarter due to fears of general economic decline as well as state budget stress. Since a large part of Courier's revenue comes from printing elementary through high school (el-hi) textbooks, investors worry about the states having enough money to buy new textbooks. Management has offset some of the el-hi business by shifting more toward higher education textbooks as colleges have seen growth in enrollment. Currently the stock has a 7% dividend yield which is well covered by cash flow.

Moving Forward

We recognize that certain (not all) economic indicators are weakening which makes forecasting the future very difficult. To some extent this has already been reflected in the weak stock market. However, we know that every Bear Market (downturn) is followed by a Bull Market (upturn). We also know from studying the stock market that the typical Bull Market is longer in duration and appreciates more than the declines experienced in down markets. This has been true for the last 100 years.

We also understand the mentality that "this time it's different." All market corrections are preceded by different economic and financial conditions as are all recoveries. Despite differences

FAM Equity-Income Fund



in every crisis, they all have common threads: investor confidence and faith in the system are always shaken and need to be rebuilt; the Government typically steps in to make sure the event will never happen again and enacts new legislation; and the media sensationalizes the bad news because it's just too early to believe, or even recognize, the positive data points that are slowly emerging.

Instead of getting bogged down by conjecture, we focus on investing in good businesses with honest and capable management teams that generate more cash than they need for their operations. We look for durable, competitive advantages that are strengthened over time. Owning these types of businesses that have promising long-term growth potential is the best hedge against the unknowable outcomes of today's or the future's issues.

As always, we appreciate your continued support and are working diligently on your behalf.

Paul Hogan, CFA
Co-Manager

Thomas O. Putnam
Co-Manager

Average Annual Total Returns as of June 30, 2010

	1-Year	3-Year	5-Year	10-Year	Life of Fund (4/1/96)
FAM Equity-Income Fund					
(Investor Shares)	16.94%	-9.03%	-2.03%	6.10%	6.49%
(Advisor Shares)*	16.00%	-10.02%	-2.99%	N/A	*
S&P 500 Index	14.34%	-9.84%	-0.81%	-1.61%	5.18%
Russell 2000 Index	21.48%	-8.60%	0.37%	3.00%	5.81%

*FAM Equity-Income Fund Advisor Shares were launched on July 1, 2003. The return since inception is 1.35%

The graph and performance table do not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares. This information represents past performance of the FAM Equity-Income Fund and is not indicative of future results.