



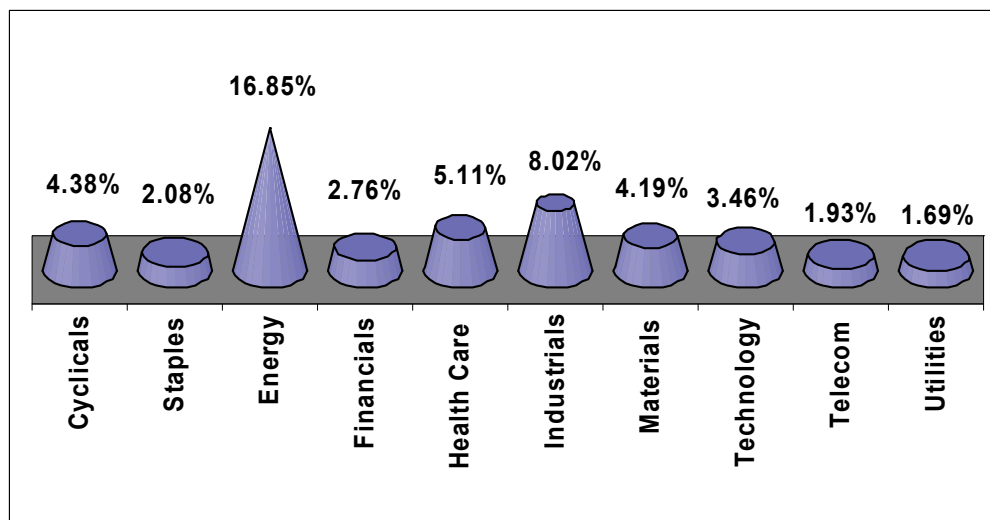
QUARTERLY INVESTMENT REPORT March 31, 2011

Dear Investor:

After a terrific run in the market last year and a solid start in 2011, the markets wavered in late January and again in late February all the way through to the Japanese earthquake and tsunami in mid March. Investors expressed unease with the political unrest in the Middle East and continuing debt troubles in Europe. **Steep stock selling in the wake of the tsunami destruction was quickly followed by opportunistic buying; the market, as measured by the S&P 500, managed a total return gain of 5.9% for the quarter.** It is surprising how well the market faced down the quarter's barrage of bad news as investors were able to separate the human tragedy from a financial one. Of course, the near-term impact on manufacturing and global supply chains is significant and analysis is ongoing. We expect Japan to recover and the effects of the devastation on the global recovery to be relatively short-lived.

All sectors performed well in the first quarter. Unsurprisingly, energy stocks ran up the most in the face of disruptions to oil flow in the Middle East and Libya, the world's 12th largest crude exporter. After losing 10% of its nuclear capacity, Japan's demand for oil will increase for power generation and reconstruction.

1st Quarter Investment Performance S&P 500 Economic Sectors



In uncertain economic environments investors get nervous and jumpy; any hint of a weakening economy around a corner may justify selling, especially if prices seem too high. **The causes of extreme market volatility this quarter were both significant and unexpected.** Who could have predicted that a colossally frustrated Tunisian fruit and vegetable seller would, on December 29, 2010, set himself on fire and ignite a sequence of protests across more than ten countries in the Middle East and North Africa. His nightmarish death, and the thousands more who subsequently died in that region and in Japan, affect us deeply on a basic human level, but our selfish survival instincts kick in swiftly as we strive to assess the potential economic affect on our lives.

Japan

According to the International Atomic Energy Agency (IAEA), as of March 30th, three of the six reactors at the Fukushima nuclear plant suffered significant damage to their core and fuel integrity. One of those three reactors (reactor #2) had severe damage with ongoing concerns over nuclear waste containment. Though this tragedy gives nuclear energy opponents a megaphone, the message seems less potent these days when reviewed in lieu of the problems facing the oil, gas, and coal industries.

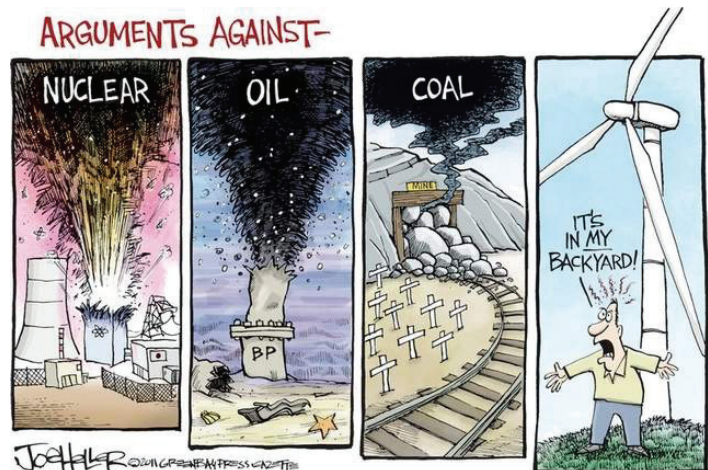
Trade-offs

Nuclear: radioactive contamination, finite uranium supplies, high construction costs, huge subsidies, radioactive wastes & no permanent storage

Oil: peak oil, wars, accidental leaks

Shale gas: groundwater contamination

Coal: carbon emissions, mercury pollution, miners' safety, mountain top removal, ruined rivers, black lung disease



Japan is the third largest economy in the world and lacks indigenous sources of fossil fuels; it is only 16% energy self-sufficient (the United States is about 70% self-sufficient). Ever since the 1973 Arab oil embargo shock Japan had pushed itself to build out a nuclear infrastructure and reduce its reliance on oil. Despite the push, it is still the third largest oil consumer in the world behind the United States and China and the third largest importer of crude oil (it's also the largest importer of both liquefied natural gas (LNG) and coal).

Japan is a hub of technological production. For example, the country produces 60% of the world's silicon wafers (thin slices of semiconductor material used to make integrated electronic circuits and other devices), 32% of the world's cars, and 74% of the navigation systems that go in all cars. Japan is also a large producer of aerospace and specialty instruments. Many companies' supply chains have been disrupted by Japan's catastrophe. Though Japan's global trade reaches far and wide, it is interesting to note that in 2010 it represented only 4.7% and 6.3% of United States exports and imports respectively.

Recent research by Accenture found that more than 60% of manufacturing executives they surveyed have considered moving production closer to where their demand for goods and services is highest. It is plausible that the Japanese disaster could spur a wave of factory

relocations in the next several years as large US manufacturers move production from Asia to the US and Latin America. The trend over the last ten years, where companies were searching for cheaper labor and material costs, could see a shift now that energy and transportation costs have gone up. Also, customers demand quicker supply times and greater customization, which is another reason for manufacturing to become more regionalized. One of many interesting examples of this trend is the fact that Procter & Gamble just opened, in March, its first new plant in the U.S. (in Utah) in 40 years. Management stated that part of the reason was that they wanted to be closer to West Coast consumers. Optimistically, if this regionalization trend develops, it couldn't come at a better time for U.S. workers in need of jobs.

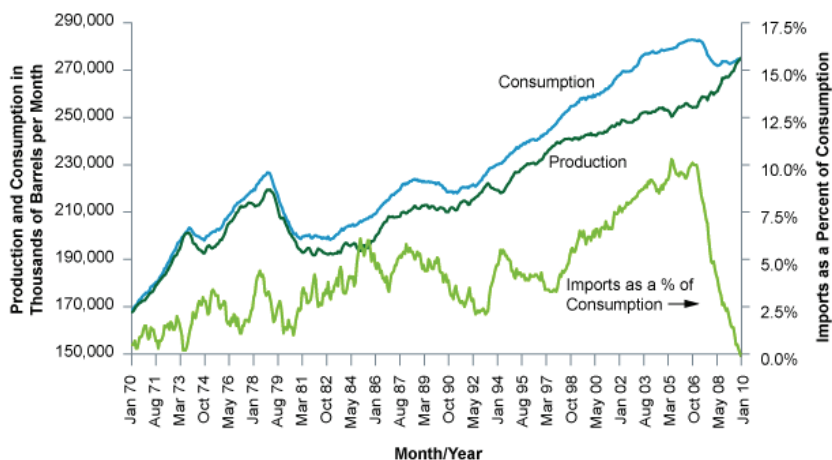
Middle East & North Africa and Oil

The fear of political instability in the Middle East and North Africa has been driving oil and gasoline prices up. Prior to the unrest Libya was pumping out 2% of global oil supplies. Saudi Arabia has since boosted its output to compensate for that loss, but the fear of disruption of supply from Saudi Arabia, Kuwait, or United Arab Emirates could push oil and gasoline prices even higher. We consume more and more energy since our economy and population keeps growing, plus we are more reliant on oil imports to meet our consumption needs. Given geopolitical uncertainties, this is, and has been, a growing concern. Fear of the unknown has driven oil prices over \$104 a barrel and futures prices close to \$108. Gasoline prices are now at a national average of \$3.60 a gallon, a high point since the recession in 2008 when prices hit \$4.11 a gallon.

Oil has low elasticity, meaning demand doesn't change much in the short term from price increases, because no real substitutes exist for large-scale heating and electricity. But it's different for gasoline consumption. The blue line in the chart below shows the trend of increasing gasoline consumption over the years; but demand was diminished somewhat as people drove less during oil shocks in 1973-1974, late 1970's to early 1980's, early 1990's, and in 2008.

U.S. Gasoline Imports Plummeted with the 2008 Price Spike and Recession

Gasoline Consumption, Production and Imports as a Percent of Consumption:
Jan. 1970 to Dec. 2010



Source: U.S. Energy Information Administration
Note: Gasoline includes all grades and formulations of Finished Motor Gasoline

Our dependence on imported gasoline (light green line) peaked in 2006-2007 and trended towards zero in 2008. That was due to the recession and because higher percentages of ethanol were allowed to be blended into gasoline to help boost domestic supply.

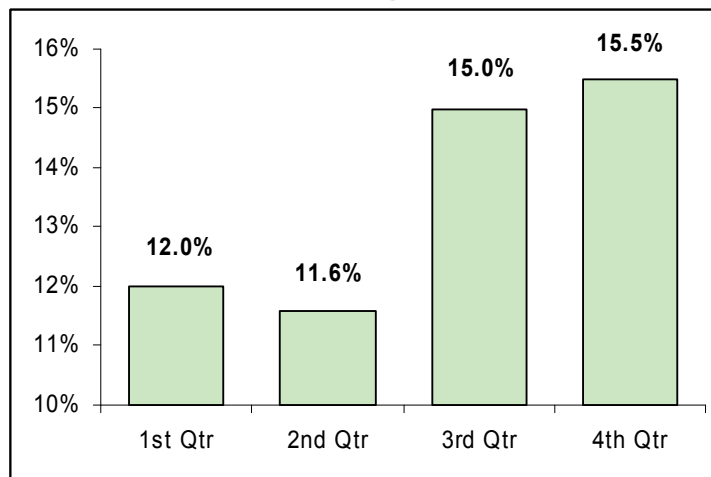
If gasoline prices climb above \$4 per gallon, consumer confidence may plummet and increase the probability of another recession.

Corporate Earnings and the Stock Market

It is interesting to see stocks do well in the face of such negative world events - rising oil and gasoline prices, inflationary pressures, interest rate concerns, European budget meltdowns, and growing federal deficits.

The numbers don't lie and stronger companies with much improved balance sheets since the 2008 recession are reaping the rewards as the recovery progresses. Investors now expect companies to stay healthy at least through 2011. In fact, analysts are projecting double-digit growth for the full year. The 1st quarter earnings numbers are due out over the next month and we shall see how close their predictions are.

Analysts Expectations 2011 Earnings Growth



We are a little less sanguine than most analysts on Wall Street, as companies must soon tackle rising pressures on profit margins from increased costs and possibly more tentative consumer demand. If the recent positive trend in hiring and jobless claims continues and if the manufacturing boom continues we will relax. But, housing starts, which are such an important part of the current recovery, are stuck in serious doldrums.

At some point, perhaps not until later in 2011, we expect the market to pull-back. Low returns from money market funds and short-term bonds, potential risk to principal from long-term bonds, and bubble-level gold and commodity prices will keep investors content for now in good old-fashioned high quality liquid stocks. **If rough waters are ahead for the market we are positioned well to mitigate substantial losses. We will proceed cautiously, remain professionally impassive to the siren song of ever higher stock prices and stick to our diversification and valuation discipline.**

Enjoy your upcoming Easter and Passover holidays!

Sincerely,

Ellen P. Le, CFA
President